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Regional Bilateral Trade Analysis of the European Union, China and ASEAN

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Abstract

This paper deals with the analysis and evaluation of bilateral trade flows between the European Union and ASEAN, and China and ASEAN. Many preferential trade agreements come into force in accordance with global efforts to liberalize trade. The European Union and China also negotiate to create preferential trade relations with ASEAN. The aim of this paper is to verify whether observed economies that form or plan to form a preferential area are *natural trading partners* or not and which economy has better position to create such agreement. The analysis uses indices of regional trade intensity and trade complementarity. The analysis clearly shows growing commercial dominance of China in Southeast Asia compared to the EU, but Chinese trade focus on the ASEAN countries weakens. From the perspective of trade complementarity it implies that the EU is more natural trading partner of ASEAN countries than China.

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1. Introduction

Southeast Asia has experienced a rapid economic expansion during last two decades supported by inflows of foreign investment and its involvement in the international trade. Countries of this region created the ASEAN integration project in 1967 based on principle of economic cooperation. This collaboration reached the culmination during 1990's when the Free Trade Agreement (ASEAN Free Trade Area) among its members was established. Currently, this integration project involves ten member countries with more than 500 million people. Despite the fact that ASEAN countries have the common goals, they are reaching a very different economic levels. The AFTA involves so-called newly industrialized countries (Singapore, Indonesia, Malaysia and Thailand) which are characterized by high dynamic of economic development and on the other hand, there are countries that belong to the least developed countries of the world (Laos, Myanmar or Cambodia). ASEAN countries produce more than 3 % of global product and they share 6.7 % of global trade.

Table 1. Basic economic characteristics of ASEAN countries.

	GDP growth (%)	GDP (in millions)	GDP per capita	Unemployment rate (%)	Inflation (%)	Public debt (% of GDP)
Brunei	1.2	16 619	39 418.46	2.7	0.46	2.36
Cambodia	6.0	14 160	978.00	0.2	2.93	28.75
Indonesia	6.2	878 425	3 588.79	6.6	4.28	24.54
Laos	7.9	9 194	1 442.46	N	4.26	52.78
Malaysia	5.6	303 488	10 350.27	3.0	1.66	55.50
Myanmar	5.0	57 764	1 185.53	4.0	2.83	48.02
Philippines	6.6	250 269	2 594.23	7.0	3.16	41.91
Singapore	1.3	270 462	51 454.95	2.8	4.53	111.00
Thailand	6.4	390 855	5 592.26	0.7	3.01	45.44
Viet Nam	5.0	140 605	1 566.97	4.5	9.09	51.31

Source: UNCTAD, 2014; World Bank, 2014; IMF, 2014;

Although all observed economies are included in the multilateral trading system, represented by membership in the World Trade Organisation (WTO), they also participate in a large amount of bilateral agreements establishing Free Trade Areas or Custom Unions, as it allows the article XXIV of the General Agreement on Tariff and Trade and the article V of the General Agreement on Trade in Services.

China has geographical, political and cultural advantage in relation to the Southeast Asia region besides the European Union and uses its economic dominance not only in the Asian region to enter into preferential trade agreements. China can provide access to the markets of the Asian and Pacific region based on *the Free Trade Area and Economic Integration Agreements* which has been joined by eight countries at the bilateral level so far. But China is also part of the Asia-Pacific Trade Agreement, and in 2008 filed a notification establishing preferential agreement with ASEAN countries, which creates the largest Free Trade Area in the world with market of more than two billion people. Import duties between China and ASEAN countries gradually reduced since 2005. Tariffs should be nullified in 2010 between China and six ASEAN developed countries according to *the Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation between the Association of Southeast Asian Nations and the People's Republic of China*. For the remaining countries (Myanmar, Cambodia, Laos and Viet Nam), there is an exception to the year 2015 (Association of Southeast Asian Nations, 2008). However, the fact is that this agreement contains many exceptions, especially in identifying “sensitive” goods, which complicates the functioning of trade between ASEAN countries and China considerably. Moreover, China still protects its market in the form of intellectual property rights, exports restrictions on raw materials, non-tariff barriers (Fojtíková, 2012). Rapid development of China's economy puts pressure on other Asian economies with which China negotiates a similar type of agreements (South Korea or Japan).

Influence of the European economy in Southeast Asia is much lower. The EU has been trying to establish trade and economic cooperation with ASEAN countries in the last years. Currently, negotiations are under way on the establishment of preferential agreements at the level of FTA with Singapore, Malaysia, Thailand and Viet Nam. Negotiations with Singapore began in 2010 and most of the chapters of this Agreement are already closed. Delay in the closure is caused by change in the status of EU institutions in the field of foreign investment, which has been delegated to them by the Lisbon Treaty. The EU is also negotiating preferential agreements with the remaining three countries. The other ASEAN countries currently benefiting from the advantages of foreign trade with the EU under the General System of Preferences or Everything but Arms system which give them preferential or duty free access to the EU market. Otherwise, the European Union is working with ASEAN through interviews in the areas of trade, investment, economic integration and others, thus preparing the groundwork for the creation of an FTA with ASEAN as a whole based on global region-to-region trade agreement (European Commission, 2014).

2. Methodology and the theoretical background of analysing bilateral trade

The aim of this paper is to verify whether observed economies that form or plan to form a preferential trade area are *natural trading partners* or not and which economy has better position to create such agreement. The analysis uses indices of regional trade intensity and trade complementarity. Both economies have certain assumptions to create trade linkages with ASEAN. For China has advantages in geographical proximity to Southeast Asia, rapid economic development and the size of the Chinese economy. The advantage for the European Union is that it has long-term and stable business relations with ASEAN countries which persist from the days of colonialism, the maturity of the EU economy and the quality of its production.

Since Lipsey (1960) there are arguments in favor of the creation of preferential trade agreements (PTA). Lipsey tried to define natural trade partner by the custom union theory where he argues that: *"the custom union is more likely to raise welfare the higher is the proportion of trade with the country's union partner and the lower the proportion with the outside world"*. As Maurice Schiff (1999) points out that many proponents of the natural trading partner hypothesis argue that forming a Preferential Trade Agreement is more likely to raise welfare if member countries already trade with each other. He also points to two versions of that hypothesis. The first confirms the natural trading partner hypothesis based on the volume of trade between partners. The second sees greater natural trading partnership based on distance and transport costs between them. There are many studies (Lipsey, 1960), Summers (1995), Wonnacott and Lutz (1989) or the European Commission (1998), which show that the creation of such an agreement between natural trading partners will not cause trade diversion effect because of their mutual trade before the conclusion of such an agreement. Wonnacott and Lutz also say that a proximity economy affects the decline of extent of trade diversion and increases the benefits of preferential trade agreement. Krugmann emphasizes that the distance already does not play such a role through technologies in transport and communication and thus the creation of preferential trade agreement will bring its participants more profits than costs.

However, to assess the natural trading partners only by the volume of their trade or distance is not tenable. The effect on the establishment of preferential trade agreements causes also a kind of trade policy, structure and development of the economy, customs level, competitiveness of the country, openness of the economy and others. Sarath Chandran (2010) points out that for the success of any Regional Trade Agreement it is necessary that the individual economies have complementary trade structure to be exploited for mutual benefit. But there are also a lot of opponents of that hypothesis. They refute above-mentioned hypothesis and claim that PTA must not always necessarily increase the wealth of those countries. For example, Bhagwati and Panagariya (1996) argue that the greater volume of trade before the conclusion of the PTA partner, the greater loss from the creation of such an agreement. In other words, the higher is the partner country's initial share, the lower is the outside country's share and hence the smaller is the scope for diverting trade. For the purpose of this paper, there will be used the definition on natural trading partner by Maurice Schiff (1999) defining this term as: *"situation characterized by complementarity in trade rather than by substitutability, ... countries tend to import what the prospective partner exports"*.

The regional trade intensity (RIT) measures if extent of trade that countries (regions) change with each other is more intensive than with other countries. By other words, the trade intensity indicator says whether a region exports more to a given destination than the world does on average or not. Trade intensity is defined by the share of a

particular destination in exports of the region under study in the numerator and by share of the destination in the exports of the world as a whole in the denominator. The result takes the value between 0 do $+\infty$, while the value higher than 1 indicates an intense trade relationship. The regional trade intensity index is defined as:

$$R_k^{ij} = \frac{x_k^{ij}/x_k^i}{x^{ij}/x^i} \quad (1)$$

where x_k^{ij} represents country i's export of goods k to country j, $x^{ij} = \sum_k x_k^{ij}$ means i's all export to country j, $x_k^i = \sum_j x_k^{ij}$ is country i's export of goods k to the world, $x^i = \sum_j \sum_k x_k^{ij}$ represents country i's export to the world aggregated over all goods. That means that the RIT index measures the share of region j in i's export of goods k relative to its share in i's overall exports. The same applies to the import side.

Second part of the empirical analysis will be examined using trade complementarity that measures the extent to which two countries are natural trading partners in the sense of what one country exports overlaps with what the other country imports (WTO, 2012). Trade complementarity index (TCI) between two countries, or economies in this case, approximates the adequacy of j's export supply to i's import demand by calculating the extent to which i's total imports match j's total exports. If the shares of sectors fit perfectly, the index should reach one hundred. If there is no relationship between the exporting country i and importing country j in commodity k, then the index will reach zero. Simply, it can be said that trade complementarity index measures how much is the country i involved in imports of country j in the group k. The TCI is then calculated as:

$$c^{ij} = 100 \left[1 - \sum_{k=1}^m |m_k^j - x_k^i| / 2 \right] \quad (2)$$

where m_k^j represents sector k's share in j's total imports from the world and x_k^i means sector k's share in i's total exports to the world. As it is obvious, the resulting value of this indicator is expressed as a percentage and it is characterized by the percentage share of country i's export on country j's import.

3. Analysis of bilateral trade of selected economies

The volume of trade has increased several fold among ASEAN countries, China and the European Union, as well as among ASEAN countries themselves over the last two decades. The ASEAN is the oldest and most dynamic economic organization in Asia. Already its original intention is not only economic cooperation, but also mutual relation in security and politics. However, the ASEAN countries have reached the greatest results in business and trade. The intra-ASEAN trade attained very low level in its infancy. For example in 1995, trade among Southeast Asian countries was in the volume of 161 bil. USD, which accounted for only about 25 % of the total trade of these countries. In 2012, internal trade of ASEAN countries reached 698 bil. USD that presented about 31 % of total trade of ASEAN countries. However, ASEAN is composed of very heterogeneous countries, not only in terms of economic maturity and size, but also from the standpoint of the population, social structure and political organization. The most involved in intra-ASEAN trade is the dominant group of six countries that achieve long term more than 80 % of the internal trade. This can be applied also for extra-ASEAN trade. These countries include Indonesia, Malaysia, Singapore, Thailand, Viet Nam and Philippines. The largest trade takes Singapore, which is also one of the most advanced countries in the world. It is followed by Thailand and Malaysia. In 1995, the trade turnover of Singapore reached 48 bil. USD, Malaysia about 39 bil. USD and Thailand more than 20 bil. USD. On the other hand, countries like Brunei or Cambodia trade amounted to only 1.5 bil. USD or 1.3 bil. USD. But in 2012, the situation was already much better, even though the vast differences in trade persist among countries. Not only that the intra-ASEAN trade has increased more than four times, but also trade underdeveloped countries have grown much faster during last two decades. In 2012, trade turnover of Singapore reached more than 163 bil. USD, in the case of Thailand it was 89 bil. USD and Malaysia trade almost 125 bil. USD. In the case of small countries such as Brunei, internal trade reached 3.6 bil. USD and 7.8 bil. USD in the case of Cambodia. The average growth of intra-ASEAN trade represented more than 16 %. In 1995, the commodity structure of trade between ASEAN countries formed by more than 50 % of the group Machinery and transport equipment (SITC7). Another 10 % belongs to group of Manufactured goods (SITC6) and Mineral fuels (SITC3) further 10 %. But in 2012, trade of Machinery and

transport (SITC7) reached only 35 % and Mineral fuels (SITC3) further 28 %. Quite high values were also noted in group Manufacturing goods (SITC6) and Chemicals (SITC5) that participated on intra-ASEAN trade both by 10 %.

The biggest trading partners for ASEAN countries are the European Union, Japan and China. This paper focuses only on bilateral trade between the EU, China and ASEAN countries. The level of trade within ASEAN countries reaches only a fraction against the trade between the EU and China and extra trade of ASEAN countries forms about 70 % of its total trade. Thus the higher volume of trade is exchanged between ASEAN and the European Union and ASEAN and China. In 1995, the EU reached a trade exchange with countries of ASEAN in the value of 104 bil. USD, while the value of Chinese trade was only 20 bil. USD. The volume of trade was therefore between China and ASEAN countries five times lower than in the case of trade with the European Union. For two decades, China has built a dominant position due to its economic boom and geographic proximity to the ASEAN countries and turned the volume of trade in its favor, as it is shown in Fig. 1. In 2012, the volume of trade between China and ASEAN countries reached the value of 374.9 bil. USD with a surplus of nearly USD 63 bil. USD. The trade turnover between the European Union and ASEAN countries amounted to 260.4 bil. USD but with trade balance deficit in the value of 20 bil. USD.

The volume of foreign trade of the EU with Southeast Asia was during the 1990's still influenced by ties from the period of colonialism which ended after the Second World War. However, in China the economic boom started during the 1990's and the country began looking for sources of its growth as well as markets for its products. The growth of trade volume began already before 2005 when the agreement on lowering tariff barriers of trade was concluded between China and ASEAN. A massive increase of trade started in 2006 on the part of imports and exports of ASEAN countries.

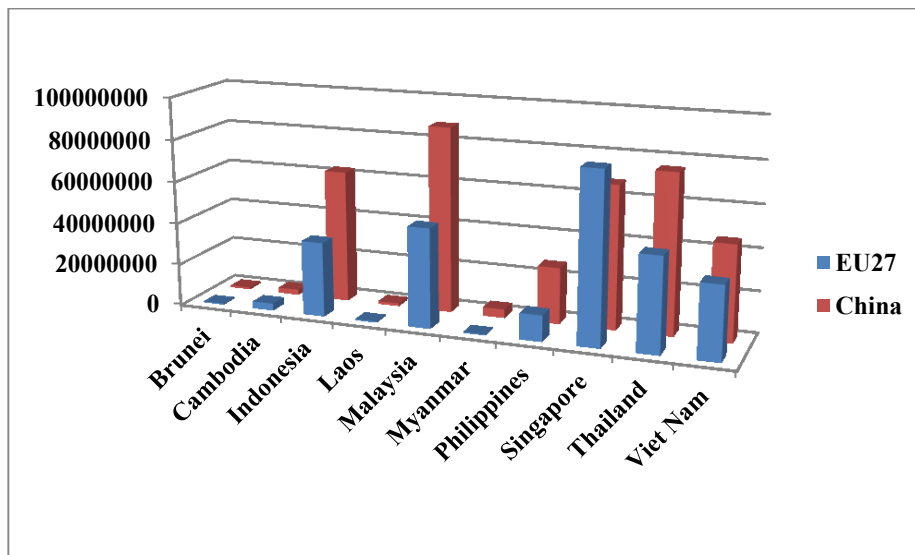


Fig. 1. Trade turnover between the EU, China and ASEAN countries in 2012.

Source: UNCTAD, 2014: own elaboration.

The commodity structure of foreign trade between China and ASEAN is mainly based on Mineral fuels (SITC3), Manufacturing goods (SITC6) and Machinery and transport equipment (SITC7). In 2012, ASEAN countries exported to China the best in Machinery and transport equipment (SITC7) in the total value of 91 bil. USD and in Mineral fuels in worth of 27 bil. USD. On the other hand, China exported to ASEAN countries the best in Machinery and transport equipment (SITC7) a total value of 93.5 bil. USD and in the group SITC6 of 36 bil. USD. The most relevant trade partners of China throughout the period are countries such as Malaysia that exchanged goods with China in 2012 in total amount of 87 bil. USD, followed by Thailand in worth of 85 bil.USD and Singapore with a total value of 67 bil. USD. The European Union mostly trade with ASEAN countries in

commodities such as Chemicals (SITC5), Manufacturing goods (SITC6), Machinery and transport equipment (SITC7) and Miscellaneous manufactured articles (SITC8). In 2012, ASEAN countries exported to the European Union the best in the group SITC7 in amount of 54,7 bil. USD and in SITC8 worth 32 bil. USD. On the other hand, the EU exported to ASEAN countries most in SITC7 a total value of 57 bil. USD. The most significant trade partners of the European Union are Singapore, where the volume of bilateral trade reached 80 bil. USD in 2012, Malaysia worth 47 bil. USD, followed by Thailand with a value of 45 bil. USD and Viet Nam with a total value of 35 bil. USD.

4. Empirical analysis

This paper analyses how the EU and China trade intensity and complementarity with ASEAN countries have changed in last eighteen years (i.e. 1995–2012). As it was already said, trade intensity measures whether extent of trade, which countries (regions) change with each other, is more intensive than with other countries. In the second part, there will be analysed the trade complementarity that measures the extent to which two countries are natural trading partners in the sense of what one country exports overlaps what the other country imports.

4.1. Regional intensity of trade among the EU, China and ASEAN

The trade intensity indicates if an economy trades more with given destination than the world does on average. The indicator theoretically takes values between 0 and $+\infty$ and the value higher than 1 indicates an intense trade relationship between these economies. It is revealed from Fig. 2 that during the whole period the EU trade is not very intensive with ASEAN countries. That means the EU exports and imports are less intense with ASEAN countries compared to its trading pattern with the rest of the world. As it was already mentioned, the natural trading partnership is determined not only by high volumes of trade, but also by proximity of trading partners. In that case has the European Union real disadvantage, especially compared to China which is directly adjacent to the ASEAN countries. There are only some exceptions. It is worth mentioning that there are two groups of commodities which reach intense trade relation throughout the period. It is group SITC1 Beverages and tobacco and SITC7 Machinery and transport equipment. While trade intensity in the first group is only a part of the EU, in the seventh group, the trade intensity is mutual. Also the group SITC6 Manufactured goods, with higher intensity of trade from the EU side, got over the value of one. Among groups that achieve low levels of trade intensity between ASEAN and the EU can be included for example SITC4 Animal and vegetable oils, SITC3 Mineral fuels and SITC0 Food and live animals.

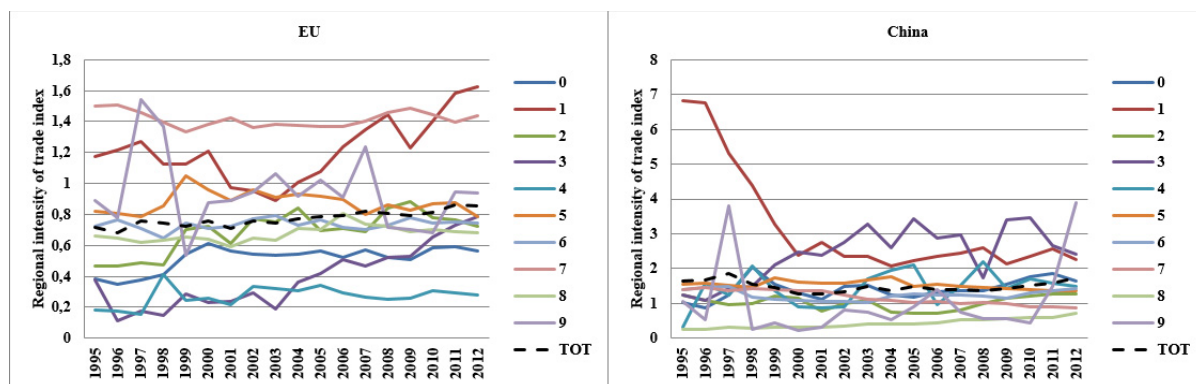


Fig. 2. Regional trade intensity between EU, China and ASEAN countries in the period of 1995–2012 by commodity group.

Source: own elaboration.

Fig. 2 clearly shows that China trade intensity reaches much higher values than in the case of the EU. The values of regional trade intensity move almost in all groups of goods above one during the whole period. China thus trades

with ASEAN countries more than the rest of the world. Geographical proximity, common economic development during last decades, common long-term business relationship and similar political and cultural behavior are all big advantages for Chinese economy. Just from analysis of regional trade intensity can be seen that China could be much more natural trade partner for ASEAN countries than the EU. Although, in some kinds of goods it leads trade intensity to considerable volatility, in general, it can be said that in all the groups the trade intensity increases. It is most visible in the case of Mineral fuels (SITC3), Animal and vegetable oil (SITC4) and Food and live animals (SITC0). In most groups, trade intensity values range from one to two. It means that the trade intensity of China and ASEAN countries is almost twice higher than the trade intensity of ASEAN with the rest of the world. In the case of Mineral fuels it is mostly three times higher than the world's average. The only exception are Miscellaneous manufactured articles (SITC8) and Commodities and transaction (SITC9). But the development of group SITC1 trade intensity is interesting. The beverages and tobacco trade intensity falls down from value seven under tree. In this group, the value of exchanged goods between China and ASEAN decreased. The reason is the replacement of this trade relation by other countries, for example the EU. As the Fig. 2 displays, the average of trade intensity moves round 0.8 in the case of the EU, but the indicator of China lies above 1.5 during the whole period.

4.2. Trade complementarity among the EU, China and ASEAN

As it was already defined, trade complementarity measures the extent to which two countries are *natural trading partners* in the sense of what one country exports overlaps the other country imports. If there is a perfect match between sectoral shares, the index would be one hundred. It is important to say that exports and imports are measured by commodity but relative to the world and not to each other. From the Fig. 3 can be noted that both economies gain high trade complementarity with ASEAN countries. However, the mutual bilateral trade of the European Union with ASEAN countries reached higher values in the entire period and still increases. That means that offer (demand) of goods of the European Union and demand (offer) of goods of ASEAN in each commodity match better, relative to the world, than in the case of China. Trade complementarity between the EU offer and ASEAN demand was in 1995 at the level of 82 % and this level, with small variations, is maintained throughout the period. In the case of complementarity between the EU demand and ASEAN offer, there can be seen constant growth. The indicator shows 83 % match between the EU imports and ASEAN exports in 1995, but in 2012 this indicator achieved almost 90 % match. China reaches in trade complementarity indices worse values and higher volatility than the European Union. In 1995 the relation between offer of China and demand of ASEAN countries was only 60 % and since this time it had been increasing rapidly until 2005. Then this indicator shows a decline to 67 % match, which was caused by a change in the structure of China export. Quite a different development than in the first case was noted in trade complementarity between China demand and ASEAN offer. As the Fig. 3 shows, the match between import of China and export of ASEAN countries began in 1995 at the level of 77 % and then was followed by a slight decrease on the level of 72 %. Since 1999 the trade complementarity index started to grow rapidly and in 2004 even surpassed indices of the European Union. After a slight decline following 2008, this indicator holds the values above 85 %. There should be noted that ASEAN exports reflect more to China and the EU imports than it is in the opposite direction. The results of trade complementarity clearly show that the structure of ASEAN offer is more consistent to demand for goods in the European Union and China. It can be caused by the existence of many Chinese and European companies in the Southeast Asian countries that produce goods for these economies. In the case of China, a great demand of natural sources that ASEAN countries can offer plays an important role. On the other side, ASEAN countries demand fits with China and European's offer less, because these countries export to ASEAN goods only in few categories that do not directly match to its whole demand.

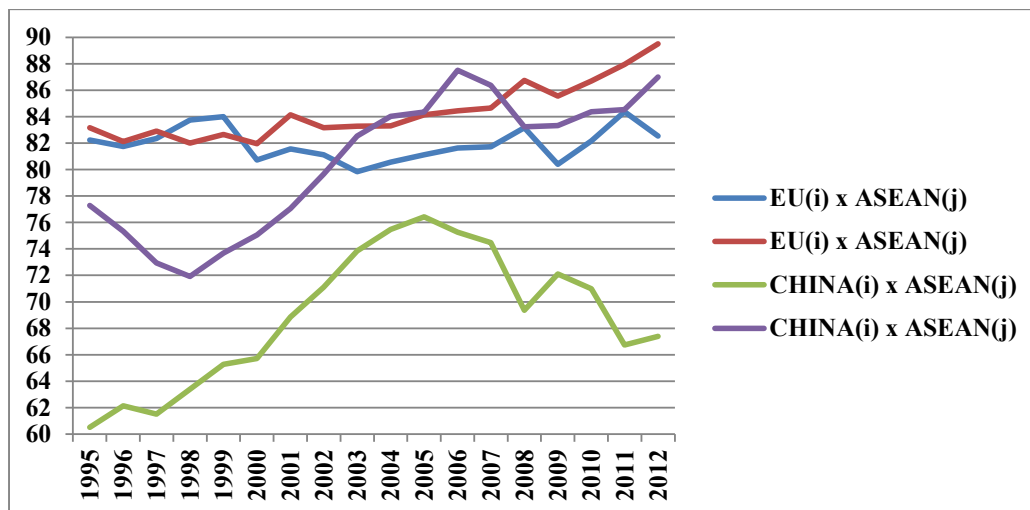


Fig. 3. Trade complementarity between the EU, China and ASEAN countries in the period of 1995–2012 (in %).

Source: own elaboration.

5. Conclusion

The aim of this paper was to verify whether observed economies that form or plan to form a preferential trade area are natural trading partners or not and which economy has better position to create such agreement. The analysis uses an approach of regional trade intensity and trade complementarity indices to determine the EU and China trade intensity and complementarity with ASEAN countries and their changes over time for the last eighteen years (i.e. 1995–2012). The analysis of bilateral trade flows show changing position of the trade influence of the European Union in the Southeast Asia that is replaced by China during the last decade. Since the year 2005, when China established Free Trade Agreement with ASEAN countries, bilateral trade between these economies had grown quickly and China outran the EU as the biggest trading partner of Southeast Asia countries. The EU exports and imports are less intense with ASEAN countries compared with its trading pattern with the rest of the world during the whole period but there are two groups of commodities which reach intense trade relation. They are groups SITC1 Beverages and tobacco and SITC7 Machinery and transport equipment. Among groups that achieve low levels of trade intensity between ASEAN and the EU can be included for example SITC4 Animal and vegetable oils, SITC3 Mineral fuels and SITC0 Food and live animals. China trade intensity reaches much higher values than the EU. China also trades with ASEAN countries more than the rest of the world in average. It is most visible in the case of SITC3 Mineral fuels, SITC4 Animal and vegetable oil and SITC0 Food and live animals where the trade intensity of China and ASEAN countries is more than twice higher than the trade intensity of ASEAN with the rest of the world. The average of trade intensity in the case of the EU is almost twice lower than indicator of China trade intensity during the whole period. But in the case of trade complementarity, the European Union reaches higher values in entire period beside China trade and still increases. That means that offer (demand) of goods of the European Union and demand (offer) of goods of ASEAN in each commodity match better, relative to the world, than in the case of China. There should be noted that as in the case of China and the European Union, the ASEAN exports match more to China and to the EU imports than it is in the opposite direction. From trade complementarity analysis results can be seen that the structure of ASEAN offer is more consistent to demand for goods in the European Union and China. The overall conclusion, therefore, is that from the view of trade intensity China keeps better position to the ASEAN countries but in the case of trade complementarity the European Union has better long term results than China. The European Union is also a better natural trading partner for ASEAN countries than China.

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